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How did budget come up short?

Despite constitutional safeguards and official directives, the state ended the last fiscal year in the red.

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JOURNAL STATE HOUSE BUREAU

PROVIDENCE — There were warnings aplenty last spring that the State of Rhode Island was about to slide into a sea of red ink.

On May 15, budget director Rosemary Gallogly put the Carcieri administration and General Assembly leadership on notice that the state was unlikely to produce the savings required by a deficit-avoidance plan signed by the governor only two weeks earlier, and was hurtling toward a $33-million deficit.

In a memo that went to the governor and key lawmakers, she listed a handful of "major areas where expenditures are expected to exceed appropriations," including the governor's inability to win union support for six unpaid days off for state employees and the failure of key state agencies to meet spending limits.

With the June 30 close of the state's last budget year bearing down, Gallogly assured the governor and lawmakers that: "Actions are being taken im-

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mediately to constrain spending." That same day, state administrators got a memo telling them to limit their spending "to only those expenditures which are critical."

"Directors, program managers and chief financial officers will be held accountable for actions taken during this critical time," said the memo issued by Gallogly and Department of Administration director Jerome F. Williams.

But those orders missed their mark, as evidenced by the belated disclosure last week of a report, by the state controller, that forever dispelled the notion that Rhode Island is barred, by its Constitution, from ending a budget year with a deficit. The governor, a retired Cookson America executive who promised to run the state like a business, ended up with a $184,152 deficit in his own office, even after shifting portions of the salaries of several of his top staffers — including his policy director — to other state agencies.

GALLOGLY

And before last week was out Republican Carcieri was proposing to do what was once considered unthinkable: take money out of the state's $102.8 million rainy-day fund to cover deficit-spending the year before on primarily routine operating expenses. The state only once before dipped into this rainy-day fund to plug a hole in a prior year's budget, and that was just last April after the discovery that the state owed a financial institution a $19-million refund on taxes paid during the 2007 budget year.

Both Gallogly and House fiscal advisor Michael O'Keefe told lawmakers it would be easier taking the money from the rainy-day fund than trying to explain to the Wall Street financial market — every time the state needed to borrow money — that Rhode Island had the money in reserve, but opted instead to forever run a deficit on its books. And "when you are explaining, you are losing," O'Keefe quipped.

So the Assembly gave its OK to this maneuver last April. The sky didn't fall. A precedent had been set. And now Carcieri wants the legislature to let him scoop another $33.6 million out of the rainy-day fund to cover last year's spending, and replenish the money this year.

How did we get to this point? Despite orders to cut spending, some state administrators simply couldn't bring themselves to do it. And state lawmakers seemed content to accept the Carcieri administration's promise of millions in unspecified cuts, rather than demand the kinds of emergency cutbacks in state-subsidized Medicaid programs, municipal aid, layoffs and government shutdown days that might have worked.

CAPRIO

As Adelita Orefice, head of the state's Office of Health & Human Services, explained last week: she tried, but the order to reduce spending by 2.7 percent — $21 million for her agencies — "was given to all of us late in the year." While she "saved" a million here and a million there, cutting more "would have had us changing eligibility, impacting thousands of people in a six-week period." She never came close. But now House leaders are promising to hold public hearings to unravel what happened. The state treasurer, Frank Caprio, and attorney general, Patrick C. Lynch, have also called for "accountability." Said Caprio: "Overspending your budget is not a good financial management practice ... If a department doesn't live within [its] budget, there should be consequences." Asked what he had in mind, Caprio said: "What would happen in the private sector? If someone didn't live within their budget, people would not keep their jobs too long." Reminded that Carcieri's office was among those that overspent, Caprio said of the term-limited governor: "He's held accountable in the court of public opinion, that's who hires and fires him."

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Extra: To read a Department of Administration memo ordering other departments to restrict spending in anticipation of a deficit, go to **projo.com**

Who then would he fire? "I would ask the governor to analyze those questions and make the appropriate decisions. These are all people who work for him."

But when asked where he stands on tapping the rainy-day fund to cover the overspending, Caprio said: "I am not in favor of poor financial management practices," but "our state Constitution calls for a balanced budget. And if the only alternative is to balance last year's budget with a one-time change in law, it is a necessary evil that I don't support, but is something that would have to be done for us to comply with the state Constitution."

After reviewing state law, Lynch punctured the long-held belief that the state Constitution bars a deficit.

"There is no constitutional requirement other than to submit a balanced budget to the legislature," he said. But that doesn't mean, he said, that overspending is without consequence.

He cited one law that allows firing, suspending or fining any state employee who "knowingly and willfully" goes over-budget. "Although it is silent about who would [impose a fine] clearly, the governor would have the authority to terminate an employee who allegedly overspent state funds," Lynch said.

He acknowledged a difference between intentional overspending and running over budget, as a family might do when faced with an unexpected doctor bill. "The governor has full authority to investigate the agencies under his control and to determine if the situation is an innocent one or one that involves culpability of one or more of his employees."

LYNCH

"It comes down to accountability," said Lynch. "We tightened our belt, our people sacrificed, and we came right in on budget. We've taken the governor's own budget director's directives seriously. Why can't the governor? This is a time for responsibility and candor, and those traits seem to be lacking."

But not everyone takes issue with Carcieri's proposed use of the rainy-day fund. Today, Gary Sasse is the governor's director of revenue, but in 1992 he was the executive director of the business-financed Rhode Island Public Expenditure Council who championed passage of the constitutional amendment that limited state spending to roughly 98 percent of anticipated revenues, and required the creation of a rainy-day fund for use in "an emergency involving the health, safety and welfare of the people of Rhode Island or the event of an unanticipated deficit."

Asked if he believes today's circumstances fit that description, he e-mailed this response: "This economic emergency is the very same reason the Rainy Day Fund was established."

He said the state is in a recession. A mid-year budget-correction bill called for a $151-million reduction in spending, and "the administration was able to eliminate all but $33.6 million of this deficit, of which $8.2 million was caused by an unanticipated decline in revenues.

"These facts constitute an emergency," he said.

And despite concerns about the potential impact on the state's credit rating, analysts at two key ratings agencies say nothing has happened that would lead them to change their already concerned view of the state's finances.

CARCIERI

Last March, the Moody's Investors Service joined with Fitch ratings in changing its outlook for Rhode Island from "stable" to "negative," so "we are aware they have been having financial challenges for a while," analyst Nicole Johnson said last week.

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"It is not a real surprise to us," Johnson said. "We certainly would like to see what their solution is, but "in and of itself, it is not a dire situation because they do have the rainy-day fund," she said. Robin Prunty, senior director of the public finance division of Standard & Poor's, echoed her assessment: "If they had no reserves, that would be a more significant issue."

So why should taxpayers care?

Here's one answer: Last year's overspending means the state is effectively $33.6 million in the hole only 2 ½ months into this budget year.

Advocates for the poor and the disabled are worried. The state's business community is warily watching what happens next.

"I don't think it is necessarily going to have an impact on businesses coming here unless it is equated to higher taxes and irresponsible administration. It is a warning sign," remarked Grafton H. Willey IV, head of the Rhode Island chapter of the Smaller Business Association of New England, a trade group for small businesses in the region.

O'KEEFE

"Obviously business can't operate that way," said Willey, putting "the blame both on the governor and the legislature" because the governor is responsible for managing the state budget, but "they both put together a budget for the last two years that had a lot of smoke and mirrors."

"It doesn't take too much to have the house of cards come tumbling down."

With reports from Staff Writer Steve Peoples.

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